

Memorandum

To: Michael Mazerov
From: Jim Peters
Date: May 14, 1997
Re: MTC Public Participation Working Group

I regret that I will be unable to attend the meeting of the Working Group in Dallas on June 17 and 18. Also, I will be out of the country from May 17 to June 4 and can only make a few informally prepared comments on the PPWG draft of Regulation IV.1. I am working on an article tracing the history of the UDITPA definition of "business income" showing its purpose and intent and suggesting an analytical approach to its application in specific situations. I hope to complete it in July. At that time I will be in a position to critique the draft. Following are my preliminary comments.

1. The Commissioners on Uniform State Laws took the definition of "business income" from language used by the California State Board of Equalization in four appeals concerning income from certain intangibles.
2. It is difficult to capture the import of language used in an opinion of an adjudicatory body based on a given fact situation in a regulation of general application. It requires inferring a general rule from language used in a specific situation. A first step is to analyze the purpose and effect of the language in the specific situation. Based on that information, a general rule can be extrapolated.
3. In Appeal of National Cylinder Gas Company, Cal. St. Bd. of Equal., 2/5/57 (one of the four cases from which the definition of "business income" was taken), the Board said: "Thus, it appears that Appellant did

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not acquire or hold the patents as an investment separate from its unitary operations." In Appeal of International Business Machines Corp., Cal. St. Bd. of Equal., 10/5/57 (another one of the four California cases), the Board explained what it meant by the acquisition, management and disposition constituting an integral part of the taxpayer's regular business operations as follows:

The expenses of maintaining the research and engineering facilities at which they were developed, the salaries of employees engaged in research and engineering work, and the cost of securing and protecting its patents, were all expenses of its regular business operations. Under such circumstances, the exploitation of its patents by licensing their use in foreign countries also constitutes, in our opinion, an integral part of Appellant's regular business activities.

4. I question the virtue of structuring the definition as a "transactional test" and a "functional test" when those terms are not part of the statutory definition but simply a construct used by the California Board of Equalization and the courts. That approach has been rejected by several state courts and poses a barrier to the regulation's adoption in those States and possibly other States as well. Also, the argument as to whether there is one test or two tests serves no useful purpose.
5. It is clear from the history of the UDITPA that it was intended that interest, dividends, and gains from the sale of securities are to be treated the same. Thus, if stock dividends are business income, so are the gains from the sale of the stock.